Comments of Constellation Energy Commodities Group, Inc.
Concerning Recent Procurement Events Held On Behalf of
Commonwealth Edison Company and the
Ameren Illinois Utilities (AmerenCILCO, AmerenCIPS, and AmerenIP)

Section 16-111.5 of the Illinois Public Utilities Act (the "Act") includes various provisions relating to the procurement of electric power and energy for Commonwealth Edison Company ("ComEd"), as well as Central Illinois Light Company (d/b/a AmerenCILCO), Central Illinois Public Service Company (d/b/a AmerenCIPS), and Illinois Power Company (d/b/a AmerenIP) (collectively, the "Ameren Illinois Utilities"). Among those provisions are requirements for the Illinois Power Agency ("IPA") to file a procurement plan for electric power and energy acquisition for those customers that are eligible to take fixed-price electric service from ComEd and the Ameren Illinois Utilities for the supply period of June 1, 2010 – May 31, 2011 ("Procurement Plan"). Consistent with the Act, the IPA filed its Procurement Plan with the Illinois Commerce Commission (the "ICC" or "Commission"). The Procurement Plan was open to comment and debate by interested parties before the Commission. In the Commission proceedings, certain aspects of the Procurement Plan were subject to input from Commission Staff and other interested parties. At the conclusion of those proceedings, the Commission entered an Order approving the Procurement Plan with certain modifications (ICC Docket No. 09-0373).

Pursuant to that Order, ComEd and the Ameren Illinois Utilities engaged third-party procurement administrators to conduct sealed-bid requests for proposals ("RFPs") for energy, capacity (Ameren only), and Renewable Energy Certificates ("RECs").[1] The

[1] Although the Order approved an RFP process for renewable energy credit and energy swap contracts (bundled together) with ComEd and Ameren extending 20 years into the future from June 2012, such RFP has not taken place and is therefore not addressed in these comments.

results of the five (5) RFPs were approved by the Commission after being supervised by a Commission-hired procurement monitor, Boston Pacific Company, Inc.

In addition to review and approval of the Procurement Plan, Section 16-111.5(o) of the Act states:

> On or before June 1 of each year, the Commission shall hold an informal hearing for the purpose of receiving comments on the prior year's procurement process and any recommendations for change.

In fulfillment of this requirement, the Commission provided public notice issued May 28, 2010, of its intent to hear all interested parties' comments relating to the above-described procurement process and its five procurement events.

Background

Constellation Energy Commodities Group, Inc. ("CCG") is a power marketer authorized by the Federal Energy Regulatory Commission to sell energy and capacity and certain ancillary services at market-based rates. CCG focuses on serving the needs of distribution utilities, co-ops and municipalities that competitively source their load requirements. CCG also sells natural gas and other commodities at wholesale, both in the United States and abroad, and holds interests in exploration and production companies. CCG does not own any physical assets for the generation, transmission, or distribution of electric power and has no retail electric customers or service territories. However, CCG bids energy, capacity and ancillary services on behalf of generation-owning affiliates into the markets administrated by PJM Interconnection, L.L.C. ("PJM") and the Midwest Independent Transmission System Operator, Inc. ("MISO").

The most recent round of procurements in Illinois, which attracted a large number of qualified bidders and ultimately winning bidders, demonstrates the benefits of the

competitive procurements when part of a well-run process.

Summary of Recommendations

CCG was an active participant in the Commission proceedings that resulted in the adoption of the Procurement Plan as well as all of the related activities leading up to each of the five procurement events currently under review. CCG submitted bids in four of the five procurement events, and was one of the winning bidders in three of those events. Based on its experiences in the recent procurement events, as well as its expertise over the years in other procurement events in Illinois and other jurisdictions, CCG proposes the following overarching recommendations for improvements to the future procurement processes to be overseen by the Illinois Power Agency ("IPA"):

1. Utilize full requirements products in the next procurement plan;
2. Reduce regulatory uncertainty by shortening the window of time between submission of bids and notification to potentially winning suppliers; and
3. Accept Green-e Certificates for REC Procurements.

Use Full Requirements Products To Minimize Customer Risks

In order to procure supply required to meet the needs of "eligible retail customers", as defined within the Public Utilities Act, the IPA should conduct future procurement events that rely upon the use of full requirements ("full requirements") products. The IPA is given discretion to procure products individually, or in combination.[2] The IPA should take into consideration the fact that customers bear greater risk with separate block products, because the shape and quantity of the load is not known, and should adjust future procurement plans accordingly by procuring full requirements contracts.

[2] 220 ILCS 5/16-111.5(b)(3)(iii).

A full requirements approach will best meet the requirements of Illinois law. It is important to keep in mind that "costs" to customers may include not only the prices paid by customers for IPA-procured supply, but the risks and lost opportunities they may face under a particular IPA plan. A full requirements approach will limit risks to customers by shifting them from the IPA, ComEd and Ameren to wholesale suppliers, while promoting opportunities for customers by providing well-defined, competitively-procured default service supply that provides appropriate benchmarks for comparisons to product offerings of retail electric suppliers ("RESs").

As risks and costs to ComEd and Ameren appropriately are passed on to its customers, it follows that the full requirements approach limits the risk to utilities' customers by shifting them largely to full requirements product suppliers. To explain, full requirements products provide consumers with insurance for the duration of the contract by shifting risk to wholesale suppliers. The situation faced in 2008 by Wellsboro Electric Company ("Wellsboro") – a Pennsylvania utility procuring its default service requirements through a managed portfolio approach – provided documented evidence as to the benefits of shifting such risk; Wellsboro faced a market "surprise" and had to seek permission from the Pennsylvania Public Utility Commission on January 30, 2008 to recover in excess of $2 million in additional congestion costs from its customers because of an unexpected congestion event.[3] Wellsboro's customers did not have the "insurance" provided by a full requirements supplier for such an event and, as a result, had to bear the

[3] *See Joint Statement of Commissioner Kim Pizzingrilli and Vice Chairman James H. Cawley*, Commission Docket No. P-2008-202057 (issued Feb. 28, 2008) ("Wellsboro Feb. 2008 Decision") at p.1.

burden themselves for the surprise rise in costs, as the Pennsylvania Public Utility Commission approved the pass through of such costs on February 28, 2008.[4]

An IPA plan relying on full requirements products provides a proper balance by obtaining the most competitive prices for consumers, while appropriately placing risks such as volume risk on wholesale suppliers. Support for this notion comes from an important study on Pennsylvania's energy future by Dr. Susan F. Tierney, a nationally recognized energy policy expert, former Assistant Secretary for Policy at the U.S. Department of Energy, and former Commissioner at the Massachusetts Department of Public Utilities.[5] Dr. Tierney documents that, through competitive full requirements procurements, wholesale suppliers bring many benefits because of their abilities and skills.[6]

A diverse pool of wholesale full requirements product suppliers provide the most cost-effective method of management for eligible retail customers. Under full requirements product procurements, utilities provide to potential bidders prior to procurements, and to winning bidders on an ongoing basis afterwards, all of the load data for their individual customer classes. Wholesale suppliers are specialists in the area of portfolio management, and have greater resources, expertise and ability to appropriately utilize this data to manage portfolios of supply at the least possible cost, by allocating the costs for their operations over much larger load obligations throughout the country. Moreover, such suppliers are able to draw from their substantial experience throughout

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4 *See* Wellsboro Feb. 2008 Decision at p.1.

5 *See Pennsylvania's Electric Power Future: Trends and Guiding Principles*, Susan F. Tierney, Ph.D., Analysis Group (January 2008) ("2008 PA Market Study").

6 *See* 2008 PA Market Study at p.11 (stating that full requirements service "taps into the abilities and skills" of different wholesale market participants).

PJM, MISO and in other jurisdictions to develop proprietary models of customer behavior and switching patterns, to refine these models, and to better analyze the local data provided by utilities. These wholesale suppliers pass on the efficiencies they achieve due to their sophisticated risk management skills and experience in the form of more competitive bids for full requirements products in competitive procurements. Wholesale suppliers have already invested in, and continue to make significant investment in acquiring, experts in each specific type of market which makes up full requirements supply.

At Constellation, for instance, hundreds of employees are involved in the process of providing full requirements service to utilities and customers around the country, serving tens of thousands of megawatts of various types of full requirements load from coast to coast. Constellation employs a team of seasoned portfolio managers for large regional portfolios that serve Constellation's customers' full requirements loads. Constellation must ensure that any transaction that goes into Constellation's entire portfolio of obligations is accounted for at the end of each day, and that requirements for the entire load are met continuously for every hour of every day of every week. A team of strategists continuously develops and improves computer models to keep track of all of the variable inputs that go into providing full requirements service; these strategists provide and analyze various scenarios that Constellation's portfolio managers may face. In addition, a fundamentals group constantly researches basic supply and demand in fuel and power markets in order to monitor macroeconomic trends that affect the costs of serving load. A 24-hour power trading desk trades power in the hour ahead, day ahead, and week ahead markets each day of the week, in order to help manage Constellation's

supply portfolio. Moreover, power managers and traders monitor and trade in not only the PJM and MISO markets, but also those in New York, New England and other markets throughout the U.S.; fuel managers do the same as fuel markets have direct effects on power markets. Similar resources focus on fuel oil, natural gas, coal, currency, emissions and renewable energy markets. Full-time meteorologists on Constellation's team continually monitor and predict the weather, so that Constellation's team can plan for weather effects on load requirements, and adjust supply accordingly. The task of meeting full requirements load supply additionally requires controllers, schedulers and dispatchers. Supporting all of these operations is a team of regulatory specialists and attorneys that monitor and participate in regulatory and legal activities which affect energy markets.

A wholesale supplier's greater expertise in these activities represents a valuable asset in evaluating and engaging in transactions for not only for complex hedges and other energy products, but for more common products in a portfolio such as block and spot market purchases. Increased levels of expertise and the ability to take on and manage a large portfolio's risks and responsibilities enable a wholesale supplier such as Constellation to provide significant competitive benefits over a smaller, less sophisticated market participant. Moreover, a wholesale supplier has the added expertise necessary to enter into more complex transactions which can provide additional appropriate management and hedging tools to further drive down costs.

Each of the tasks and positions described for Constellation's team plays an integral role in being able to drive down a wholesale supplier's costs of meeting load requirements and provide the most reliable, up-to-the minute improvements and

adjustments to a portfolio of resources, from which all of the supplier's customers will benefit. Without the benefits of accurate and around-the-clock weather monitoring and predicting, if an IPA plan estimates a need and purchases block products ahead of time to meet a utility's expected eligible retail customer load for the summer, one can, for instance, evaluate a situation where there happens to be an unusually hot week in the middle of July. The utility may face a situation where, because of the unusually hotter weather, homes and businesses are requiring *much* more electricity to run their air conditioners. If the IPA plan did not accurately predict how much load it would have in that week, because of that inability to accurately predict and react to the weather, the utilities may face a situation where they need to purchase in the spot market the additional supply that it requires at *high* electricity rates because, as demand for electricity increases around the region during a hot week, supply becomes constrained and prices for limited supply increase. The utility's consumers will bear the burden of the costs of this inability to accurately predict and plan for the weather in real-time.

Constellation and other wholesale suppliers continually monitor and predict the weather as part of their portfolio management function and are able to react in real-time and adjust supply accordingly and efficiently, with an incentive to keep costs low. The costs for all of the above types of expertise are mitigated significantly by utilizing a well-developed infrastructure and spreading the overhead for such activities across a supplier's entire portfolio of tens of thousands of megawatts of supply obligations across the country. Additionally, the costs for full requirements product suppliers to provide such service for a utility's eligible retail customers will be highly constrained by the very competitive nature of this business, because wholesale suppliers throughout the market

have operations similar in structure to those of Constellation, and will compete to serve a utility's eligible retail customers at the lowest cost. In addition, it is important to point out certain significant results from a recent analysis ("2010 Procurement Structure Analysis") conducted on behalf of Narragansett Electric Company d/b/a National Grid's ("National Grid"), and filed in the Rhode Island Public Utilities Commission's ('RIPUC") proceeding to consider National Grid's procurement structure for Standard Offer Service ("SOS"), Rhode Island's equivalent of utility supply service to eligible retail customers.[7] The 2010 Procurement Structure Analysis provides an important and unique technical assessment based on advanced modeling, to compare and contrast "the relative costs and risks of different approaches to serve mass market customers, and how different approaches could impact customers' supply rates."[8] While the Analysis suggests that a managed portfolio approach may, in fact, generally be cheaper than a full requirements structure, it is cheaper only by the narrowest of margins – *roughly only $0.72/MWh*.[9] However, for this very limited benefit in cost due exclusively to the price for supply, consumers will be faced with *considerably more costs due to increased risks*.[10]

It is true, however, that wholesale suppliers bidding on full requirements products may indeed place a certain value on the risk that they assume, for instance, for customer migration. The calculation for this monetization will depend on an individual wholesale

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7 *Analysis of Standard Offer Service Approaches for Mass Market Customers*, RIPUC Docket No. 4041 (submitted Jan. 22, 2010) ("2010 Procurement Structure Analysis")

8 2010 Procurement Structure Analysis at p.2.

9 *See* 2010 Procurement Structure Analysis at p.12 and p.15 (explaining that the full requirements Structure results in an expected SOS rate of only $0.72/MWh more than an alternative Managed Portfolio Approach).

10 *See* 2010 Procurement Structure Analysis at p.20.

supplier's perception of the level of such risk, its ability to manage the risk and its appetite for assuming the risk. By removing the potential for monetization and management of this risk by suppliers, a managed portfolio approach takes the actual risk and places it on consumers. In other words, it is a zero sum game. Customers bear each "cost," either in the price or in the form of an assumed risk. This type of shifting of risks directly to consumers fundamentally alters the nature of the product being provided .

Proponents of a managed portfolio approach often make claims that these monetizations and costs are exclusive to full requirements products. This claim, however, represents the false assumption that products such as block products in a managed portfolio approach will avoid (or else place on customers) most of the risks that are monetized in a full requirements product. In fact, block products include all of the same risks – and, in turn, monetization of risks – as full requirements products for items including, but not limited to, rising fuel costs, inflation, new energy taxes, market rule changes, market price changes prior to bid acceptance, and changes in credit standing. It follows that the only risk that may not be priced into the costs for block products is that of load variation, including variation due to customer migration. However, as explained above, if the fixed costs for the added benefits of full requirements products – *including* for load variation – are highly constrained through the competitive nature of full requirements product procurements, then it would be difficult to imagine that a managed portfolio approach could result in more competitive prices than those achieved under the full requirements product procurements.

Detractors of full requirements structures also often suggest that a profit is added into a bid which is otherwise avoided when purchasing other products that may be

procured under a managed portfolio approach. In reality, any product that is purchased in the wholesale markets – e.g., whether a full requirements product, a block product or a spot market purchase – will include in its price some level of profit that the supplier is willing and able to receive. Basic economic principles suggest that this is the case. When a seller sells a product – whether he is selling oranges, widgets or electricity – he seeks a return on his costs of producing the product. Basic economic principles also suggest that the price that a seller is "willing" to sell his product for will be constrained by the price he is "able" to sell his product for, so that in a competitive procurement, where only the lowest price from a pool of sellers is accepted, each seller will have an incentive to drive down the price at which he is "willing" to sell his product. This competitively constrained price for a full requirements product will include a seller's perceived monetizations of risk as well as a profit on the overall full requirements product. Depending on a supplier's perception of the level of risks, its ability to manage risks and its appetite for assuming risks, a supplier may have an ability to drive down further its underlying costs and overall prices. This especially is true for suppliers that are able to spread their costs across a large portfolio of supply obligations – if a supplier experiences lower revenue or a loss due to one of its obligations, for example, it is able to offset it against earnings across its entire portfolio of obligations. A utility relying on a managed portfolio approach has neither the competitive incentives to drive down its costs for managing risks nor the ability to hedge its obligations and costs across a broad, multi-regional portfolio.

Finally, it is important to keep in mind that all of these allegations against full requirements products regarding relative costs appear not to be borne out when carefully

analyzed – once again, the well-developed 2010 Procurement Structure Analysis suggests that the difference in consumers' prices for accepting the costs of increased risks under a managed portfolio approach rather than placing such risks on suppliers through a full requirements structure is roughly *only* $0.72/MWh.[11]

As outlined above, reliance upon full requirements products achieves several benefits. The IPA can best access competitive wholesale markets by procuring full requirements products, rather than by trying to purchase individual components of service (*i.e.*, energy, capacity, RECs, etc.) on its own.

Reduce Regulatory Uncertainty

The time period between the submission of bids and the timing that potentially winning suppliers are notified should be shortened, to the extent possible. Both the IPA and the Commission are to be commended for reducing the time period between submission of bids and contract execution. The IPA Plan resulted in submission of potentially winning bids in a shorter time frame than the outside limits established under the law, and the Commission likewise expeditiously evaluated and approved the results of the procurement events during this most recent procurement cycle. However, further improvements can be made in shortening the time period for "informal" notification to potentially winning bidders.

The longer that bids must remain open, and be subject to the possibility that bids will be renegotiated or rejected during a review process that does not define the criteria for such renegotiation or rejection, the greater the likelihood that consumers will

[11] *See* 2010 Procurement Structure Analysis at p.12 and p.15 (explaining that the full requirements product structure results in an expected SOS rate of only $0.72/MWh more than an alternative Managed Portfolio Approach).

ultimately be economically harmed. While bids are held open during the review process, bidders retain the risk that market prices will change suddenly or unexpectedly. This risk is particularly important in procurement events involving Block Energy Products, given the volatility in today's market. Potential suppliers have to incorporate such risks in their bids to account for this time lag. These risks will necessarily translate into bid prices.

Decreasing the length of time between submission of the bid and notification of likely bid award decreases the risk that suppliers bear, which would likely lead to lower overall bid prices. Such a result is consistent with the legislative mandate that:

> The Commission shall approve the procurement plan if the Commission determines that it will ensure adequate, reliable, affordable, efficient, and environmentally sustainable electric service **at the lowest total cost over time**, taking into account any benefits of price stability.[12]

Given that the Block Energy Products are standard wholesale energy products, the review of these bids should be relatively straightforward, and should not require negotiation or additional review time. Constellation appreciates the efforts by the procurement administrators to convey their recommendations to the Commission expeditiously, and the Commission's prompt action in reviewing those recommendations. However, any time that can be shaved off of the current process is of benefit to suppliers, and therefore ultimately will inure to the benefit of ratepayers.

A potential solution to the above concern can be addressed by requiring the procurement administrators to notify likely winning and losing bidders (e.g., whether or not the bidder's name is being submitted to the ICC as one of the group of qualified bidders with the lowest overall prices), subject to ICC approval, as soon as possible on the same calendar day that bids are submitted. As stated above, the review of bids for

[12] 220 ILCS 5/16-111.5(d)(3) (emphasis added).

standard Block Energy Products should be relatively straightforward, and should not require additional time. At a minimum, bidders should receive notification of the Procurement Administrator's recommendation to the ICC at substantially the same time that the recommendation is delivered to the ICC. This process was followed throughout the ComEd procurement processes, but was not followed in the Ameren procurement processes, despite requests over the course of several years. This is of particular importance for the energy procurement, in which there is the greatest price volatility.

Accept Green-e Certificates for REC Procurements

Future procurement events can benefit from standardization and clarification by accepting Green-e certificates for REC Procurements. In the recent REC RFP for ComEd, bidders were permitted to deliver RECs only through PJM-EIS GATS or M-RETS, and were therefore precluded from utilizing RECs that carried a Green-e wholesale certification, which is commonly recognized in the national renewables market. In order to be certified as Green-e, organizations offering such products must meet the requirements for renewable resources detailed in the national Green-e Energy Standard; abide by a professional Code of Conduct that governs the marketing and business practices of the participating organizations; follow the Green-e Energy Customer Disclosure Requirements including providing the customer with a Product Content Label for the certified renewable energy option, which identifies the renewable resource type they supply (such as wind or solar) and the geographic location of the renewable energy generator, and providing customers with simple, clear Price, Terms and Conditions for the renewable energy option; and undergo an annual verification process audit to ensure that they are buying enough of the right types of renewable energy to match their certified

sales to customers.[13] In short, use of a Green-e product carries sufficient rigor that it ought to be viewed (and is widely viewed) as possessing the same reliability as a GATS or M-RETS product, and thus permitted to be utilized for REC supply in future ComEd REC procurements. Increasing the number of reliable, eligible products can only serve to increase the number of offers, and thus ensure that ComEd and ultimately its customers are receiving the best possible price for RECs.

Conclusion

Constellation recommends that future procurement plans and procurement events conducted by the Illinois Power Agency and evaluated by the Commission reflect these improvements to the procurement process. Constellation is confident that its recommendations will promote continued development of Illinois' competitive retail markets, for the ultimate benefit of Illinois consumers.

Respectfully Submitted,

CONSTELLATION ENERGY COMMODITIES GROUP, INC.

Cynthia Fonner Brady
Senior Counsel
Constellation Energy Resources, LLC
550 West Washington, Blvd., Suite 300
Chicago, IL 60661
312.704.8518 (p)
cynthia.brady@constellation.com

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[13] http://www.green-e.org/getcert_re.shtml